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206 Kirchner Ct
Annapolis, MD 21401
(202) 512-2680

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1601 K St, NW
Washington, DC 20006
(202) 778-9428

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PO Box 748, MZ 1237
Fort Worth, TX 76101
(817) 777-1706

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James A. Hughes
3734 N Woodrow St
Arlington, VA 22207
(703) 387-4814

BUDGET AND FINANCE OFFICER

Jeri Kaylene Somers
1800 F St, NW, Ste 600
Washington, DC 20405
(202) 606-8831

SECTION DELEGATES

John S. Pachter
8000 Towers Crescent Dr, Ste 900
Tysons Corner, VA 22182
(703) 847-6260

Mary Ellen Coster Williams
717 Madison Pl, NW, Ste 612
Washington, DC 20005
(202) 357-6660

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555 Twelfth St, NW, Ste 730
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(202) 942-5720

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Marilyn Neforas
321 N Clark St, M/S 19-1
Chicago, IL 60654
(312) 988-5596

Writer's Address and Telephone

1601 K. Street, NW
Washington, DC 20006
(202) 778-8428

August 29, 2014

VIA EMAIL

Defense Acquisition Regulations System
Attn: Ms. Amy Williams, Deputy Director
Room 3B855, 3060
Defense Pentagon
Washington, DC 20301-3060

**Re: DFARS Case 2014-D003; Taxes—Foreign Contracts in Afghanistan,
Proposed rule, 79 Fed. Reg. 35715, June 24, 2014**

Dear Ms. Williams:

On behalf of the Section of Public Contract Law of the American Bar Association (“the Section”), I am submitting comments in the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section’s governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.¹

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.²

I. Introduction

The Section wishes to express its support for efforts to ensure that commitments concerning the taxation of United States Department of Defense (“DoD”) contractors (“defense contractors”) supporting important work in Afghanistan are respected. And we hope that the Department of State will be successful in securing clear commitments from the Government of the Islamic Republic of Afghanistan on this important issue.

¹ Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

² This letter is available in pdf format under the topic “Battlespace and Contingency Procurements” at: <http://apps.americanbar.org/contract/federal/regscmm/home.html>.

DFARS Case 2014-D003; Taxes—Foreign Contracts in Afghanistan, Proposed Rule, 79 Fed. Reg. 35715, June 24, 2014 (the “Proposed Rule”) “notif[ies] contractors of requirements relating to Afghan taxes,” but in doing so transfers the risk and responsibility for an international dispute between sovereigns to defense contractors and subcontractors who have neither the ability nor the authority to resolve the disagreement. Until there is a clear agreement resolving the impasse between these nations, we urge that the rulemaking effort be suspended so that defense contractors and subcontractors are not unfairly burdened with these risks and responsibilities. At a minimum, the Proposed Rule should be revised to allow contracting officers to relieve defense contractors and subcontractors of the risks and responsibilities when appropriate.

II. Background on Taxation of DoD Contractors and Subcontractors in Afghanistan

The Proposed Rule requires contractors (and their subcontractors) to exclude any Afghan taxes from their prices under defense contracts. In so doing, it shifts to contractors the problem and associated risk of addressing conflicting demands of the Afghan and United States governments. Contractors are placed between the two sovereigns without any ability to resolve the bilateral dispute or to mitigate the related financial and performance risks. Under the Proposed Rule, defense contractors cannot include in their contract prices the taxes that Afghanistan often requires contractors to pay.³ Non-payment places risks on the contractors’ ability to perform and to protect their employees from arrest.

A. The U.S.-Afghan Dispute over Taxation Primarily Impacts Defense Contractors.

The Proposed Rule fails to address the very real and significant problems defense contractors face as a result of an on-going dispute between Afghanistan and the United States over the scope of the tax exemption included in the bilateral agreements the nations have entered into. A 2013 SIGAR⁴ report documents the dispute between Afghanistan and the United States, and the severe repercussions facing contractors and their subcontractors who refuse to comply with the direction from the Afghan government: “As a result of the outstanding [tax] assessments [on U.S. contractors], the [Afghan Ministry of Finance] has restricted contractors’ freedom of movement and refused to renew business licenses, and the Afghan government has even

³ United States and Afghan authorities agree that any Afghan citizen employed by NATO/ISAF contractors or local contractors are no longer tax exempt and may be taxed according to Afghan tax law as of March 21, 2011. Thus, defense contractors remain responsible for withholding tax from the wages of the Afghan employees and remitting those payments to the appropriate Afghanistan taxing authority.

⁴ Special Inspector General for Afghanistan Reconstruction

arrested some contractor personnel. The combined effect is the potential interruption of support to U.S. military operations.” SIGAR Audit 13-8, TAXES: AFGHAN GOVERNMENT HAS LEVIED NEARLY A BILLION DOLLARS IN BUSINESS TAXES ON CONTRACTORS SUPPORTING U.S. GOVERNMENT EFFORTS IN AFGHANISTAN (“SIGAR Report”), May 2013, at 2.⁵

The SIGAR Report notes at page 13, “Despite requests from contractors for clarification on taxation issues, especially on the question of subcontractor tax exemption, U.S. government agencies, so far, seem unable to provide a definitive and unified response.” The current process for obtaining a tax exemption requires confirmation that a contract is tax exempt from both the United States and Afghanistan. The first step requires that the contractor obtain a letter from the U.S. government agency’s contracting officer, providing details about the contract, including the contract number, value, and period of performance. SIGAR Report at 12. The contractor must then submit an application for a tax exemption, including the letter, to Afghanistan’s Ministry of Finance (“MOF”), which then either grants or denies the application. The Proposed Rule does not address the situation documented in the SIGAR report where the MOF denies the contractor’s (or subcontractor’s) request for a tax exemption certificate and the United States asserts that the contract is exempt from the assessed foreign tax, yet DoD denies the Defense contractor any reimbursement.

Afghanistan’s official position is reflected in letters responding to contractors’ petitions for certificates of tax exemption and is recorded in the SIGAR Report as well as in a 2011 white paper authored by the Professional Services Council (“PSC”).⁶ As the SIGAR reports, the Afghan MOF contends that subcontractors are not entitled to tax exemption and it maintains that prime contractors must withhold tax for non-Afghan subcontractors.⁷ SIGAR reported that 17 defense contractors had been assessed a total of \$93 million in Afghan taxes. *Id.* at 6, Table 2. PSC’s white paper reported that Afghan tax assessments often ranged from \$1 - \$3 million or more, and that the contractors’ failure to pay those bills led to the Afghan government’s impoundment of goods and refusal to renew the contractors’ business licenses. PSC White Paper at 3.

Because all contractors are required to file annual tax returns in Afghanistan, even if their contracts are tax-exempt, and annual renewal of business licenses is

⁵ Available at <http://www.sigar.mil/pdf/audits/2013-05-14-audit-13-8.pdf>.

⁶ The PSC White Paper, UNPRECEDENTED EFFORTS BY AFGHANISTAN TO IMPOSE TAXES ON U.S. ASSISTANCE CONTRACTS, September 20, 2011 is available at http://www.pscouncil.org/PolicyIssues/InternationalDevelopment/InternationalDevelopmentIssues/White_Paper_Unpreced.aspx?WebsiteKey=fae489a9-a93a-4c2d-9230-615ba5cc8e5e.

⁷ There was a wholesale revision of the Afghan tax laws in 2009 that imposes upon even exempt entities the obligation to file tax returns, and makes prime contractors responsible for withholding and remitting taxes for their subcontractors. The effect of these changes has been to empower the Afghan government with knowledge about contractors and their vendors and to impose tax assessments based upon that knowledge. PSC White Paper at 4. The U.S. and Afghan governments agree that the DoD prime contractors are responsible for tax withholdings for Afghan subcontractors.

premised upon presenting a tax clearance letter from the MOF, it is not possible for contractors to avoid this process. *See* SIGAR at 3. In fact, contractors may be in the best position to understand when paying a disputed tax will prevent the assessment of additional fees and penalties, up to and including a 100% penalty that may be assessed where a contractor is deemed by the MOF to be “evading” its tax obligations. *Id.*

B. DoD Has Until Now Treated Afghan Taxation as a Matter Of Contract Administration.

In a March 29, 2011 Memorandum For Director of Defense Procurement and Acquisition Policy (“DPAP”),⁸ DoD’s Office of General Counsel indicated that it would “continue to resist direct questions from contractors and their representatives, and will consistently inform such persons that they need to contact their respective DoD contracting officers or their representatives.” The “Fact Sheet” attached to that memorandum asserted DoD’s position that “The U.S.-Afghanistan SOFA’s tax exemption provisions cover DoD contractors, subcontractors, and their U.S. or other non-Afghan employees.” Despite its settled opinion concerning the impermissibility of taxing U.S. government contractors and subcontractors in Afghanistan, the DoD General Counsel’s office refused to answer contractors’ legal questions, treating Afghan taxation as a matter of contract administration to be handled by individual contracting officers.

Individual contracting officer assistance with the Afghan MOF has, however, been inconsistent at best. The SIGAR Report indicates, and the Section has been informed, that some contracting officers assist prime contractors in trying to secure tax exemptions and other contracting officers have been unwilling to assist contractors or subcontractors in trying to secure exemption letters from the Afghan MOF. In some cases, DoD has, in fact, reimbursed prime contractors for Afghan taxes paid, as evidence by the SIGAR Report and by a provision of the 2014 National Defense Authorization Act (“NDAA”), Pub L. No. 113-66, 127 Stat. 672, which seeks to quantify and recover such costs from Afghanistan as discussed below.

C. Congress Recognizes That DoD Contractors Are Being Taxed by Afghanistan.

Section 1216 of the 2014 NDAA mandates that DoD withhold from appropriated 2014 funds an amount equal to the total amount of taxes assessed by Afghanistan on all DoD assistance during Fiscal Year 2013. That provision recognizes the reality contractors face and imposes upon DoD a responsibility to report taxes assessed and to withhold equivalent amounts if the Secretary of Defense certifies that “such taxes have not been reimbursed by the Government of Afghanistan to the Department of Defense or the grantee, contractor, or subcontractor concerned.” 2014

⁸ Available at http://www.acq.osd.mil/dpap/pacc/cc/docs/Contractors_in_Afgh-Iraq-Assistance_in_Responding_to_Qs_RE_Taxation_under_Resective_SOFAs.pdf.

NDAA § 1216(a), 127 Stat. 908-09. Congress provided that the requirement would terminate when a new bilateral agreement with Afghanistan takes effect. *See id* at § 1216(e), 127 Stat. 909.

III. Section Recommendations

A. The DAR Council Should Delay Implementation until the Taxation of DoD Contractors in Afghanistan Is Clarified in a Bilateral Agreement.

Unless and until there is clarity and agreement between the U.S. and Afghan governments on the interpretation and enforcement of bilateral agreements concerning taxation of DoD contractors and subcontractors, the Proposed Rule should not be implemented. While there has been significant attention to this issue in recent years, nothing has changed for contractors stuck in the middle of this dispute. The Section appreciates that DoD and Congress do not want to pay taxes on goods and services associated with DoD efforts in Afghanistan in violation of the bilateral agreement between the U.S. and Afghanistan. We also understand the concern that reimbursing Afghan taxes might encourage or implicitly condone the taxation. But the Afghan position is well-established, and DoD contractors and subcontractors are being taxed and threatened with severe consequences for refusing to pay taxes. This Proposed Rule will do nothing to change that. Under the Proposed Rule, unless contractors are willing to risk losing their business license in Afghanistan or other penalties from the Afghan government, contractors and subcontractors must withhold taxes from their employees and pay them to the Afghan government, incurring costs expressly in performance of their contracts with no hope that DoD will reimburse these costs.

Furthermore, the U.S. government, in particular the Department of State (“DoS”), is the entity responsible for negotiating international agreements and, unlike DoD contractors and subcontractors, the DoS can engage the Afghan government in a dialogue concerning the tax issue. The SIGAR Report, however, suggests that DoS is focused on cementing a new bilateral agreement rather than assisting contractors with current taxation problems with the Afghan government under the existing regime. *Id.* at 10. Given this focus on a new pending bilateral agreement that could conceivably change the treatment of contractor taxation, this rule is premature because it will only ensure that contractors and subcontractors cannot be reimbursed for these costs and it will potentially deter contracting officers from dealing with the Afghan government’s improper attempts to collect taxes from these contractors.

B. The DAR Council Should Revise the Clause to Require Contracting Officers to Provide Direction to Contractors in Those Cases in Which the Host Country Fails to Honor the U.S.-Afghan Agreement on Taxation.

If this rulemaking is not postponed or cancelled, the Section recommends that the Proposed Rule be modified to account for and address the reality of this dispute among sovereigns. The Section's proposed modification would advise contractors of

the U.S. position on taxes and require the contractor to notify the contracting officer if the Afghan MOF denies its tax exemption. In those cases, the agency would be required to provide direction to the contractor by either (i) directing the contractor to pay the foreign taxes, entitling the contractor to reimbursement, or (ii) directing the contractor not to pay the foreign taxes, while holding it harmless from the consequences of that failure. To clarify its proposed modification, the Section provides the following proposed language in *italics* below:

DFARS 252.229-70XX Taxes—Foreign Contracts in Afghanistan.

TAXES—FOREIGN CONTRACTS IN AFGHANISTAN (DATE)

(a) This acquisition is covered by the Agreement regarding the Status of United States Military and Civilian Personnel of the U.S. Department of Defense Present in Afghanistan with Cooperative Efforts in Response to Terrorism, Humanitarian and Civic Assistance, Military Training and Exercises, and other Activities, entered into between the United States and Afghanistan, which was concluded by an exchange of diplomatic notes (U.S. Embassy Kabul note No. 202, dated September 26, 2002; Afghanistan Ministry of Foreign Affairs notes 791 and 93, dated December 12, 2002, and May 28, 2003, respectively), and entered into force on May 28, 2003.

(b) The Agreement exempts the Government of the United States of America and its contractors, subcontractors, and contractor personnel from paying any tax or similar charge assessed within Afghanistan. The Agreement also exempts the acquisition, importation, exportation, and use of articles and services in the Republic of Afghanistan by or on behalf of the Government of the United States of America in implementing this agreement from any taxes, customs, duties, or similar charges in Afghanistan.

(c) The Contractor shall exclude any Afghan taxes, customs, duties, or similar charges from the contract price.

(d) The Agreement does not exempt Afghan employees of DoD contractors and subcontractors from Afghan tax laws. To the extent required by Afghan law, the Contractor shall withhold tax from the wages of these employees and remit those payments to the appropriate Afghanistan taxing authority. These withholdings are an individual's liability, not a tax against the Contractor.

(e) In the event the Government of Afghanistan denies a tax exemption for taxes referenced in section (b) from the Contractor, the Contractor shall promptly provide written notice to the Contracting Officer of the denial, including all materials relevant to the denial.

(f) The Contracting Officer shall investigate the circumstances of the denial of the tax exemption promptly after receiving the notice. After such investigation and consultation with legal counsel, the Contracting Officer shall notify that contractor in writing whether (i) to comply with the Government of Afghanistan's determination and pay the taxes or (ii) to refrain from paying the taxes. If the Contractor is directed to pay the taxes, the Contractor shall be entitled to an equitable adjustment equal to the tax assessment and the contract shall be modified in writing accordingly, notwithstanding section (c). If the Contracting Officer directs the Contractor not to pay the taxes, the Contractor shall be excused from any impacts to its performance of the Work associated with its failure to remit taxes to the Government of Afghanistan.

(g) The Contracting Officer is authorized, in exigent circumstances, to authorize the payment of foreign taxes. Within 15 days after the authorization is provided, the contracting officer shall prepare a written determination explaining the rationale for the authorization.

(h) No request by the Contractor for an equitable adjustment to the contract under this clause shall be allowed unless the Contractor has given the written notice required. The Contracting Officer's decision under this clause shall constitute a final decision of the Contracting Officer pursuant to FAR Subpart 33.2.

(i) The Contractor shall include the substance of this clause, including this paragraph (i), in all subcontracts, including subcontracts for commercial items.

(End of clause).

We think that these changes to the Proposed Rule would serve the dual purposes of notifying contractors of their responsibilities, but would protect contractors from bearing the costs arising from a dispute they have no ability to resolve.

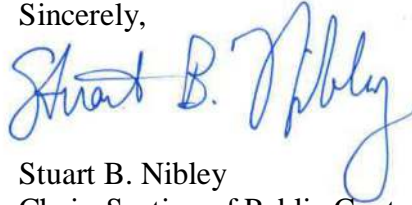
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IV. Conclusion

The Section strongly supports the efforts by the DAR Council and DoD to ensure that agreements concerning the taxation of prime and subcontractors working in Afghanistan are respected. Unfortunately, this Proposed Rule will not address the root problem and instead transfers the risks and liability of this dispute among nations to contractors who lack the authority to resolve the conflict. Consequently, the Section urges the DAR Council to cancel this rulemaking or to make the recommended revisions and delay implementation of the Proposed Rule until after the issue of taxation has been clearly and bilaterally resolved with the Afghan government.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,



Stuart B. Nibley
Chair, Section of Public Contract Law

cc: David G. Ehrhart
James A. Hughes
Aaron P. Silberman
Jennifer L. Dauer
Council Members, Section of Public Contract Law
Chairs and Vice Chairs, Battle Space and Contingency Procurements Committee
Kara M. Sacilotto
Craig Smith